



ENERGY PRICING AND FISCAL PRINCIPLES

KEY PROPOSITIONS

The seminar on Energy Pricing and Fiscal Principles sponsored by Energy Options and the C.D. Howe Institute was convened in Vancouver on November 15-17, 1987 to address the following question:

What are the principles upon which energy pricing and taxation policies should be based?

The seminar featured presentations from a number of well-known energy analysts.

- (1) Morris Adelman of MIT and Paul Bradley of UBC observed that there is no shortage of oil or natural gas in world markets, current or impending. They challenged the simplistic view of exhaustibility of energy resources that pictures using up the stock as similar to emptying a cookie jar. They are thus skeptical of government intervention to regulate energy prices or control quantities.
- (2) Bruce Doern of Carleton University reviewed the impact of the Canada-U.S. Free Trade Agreement on Canadian energy policy and discussed how the conflicting forces of nationalism and continentalism are reflected in the Agreement.
- (3) Andre Plourde of the University of Ottawa reviewed energy pricing, export and taxation policies over the 1974-84 period. He found that energy pricing policies and export controls had a significantly negative impact on the economy. He also concluded that the energy fiscal regime has actually been a series of systems that have been adjusted each time there was a major change in energy prices. He argued that a better approach would be to try to build more flexibility into the fiscal regime to enable it to better handle energy price and supply disruptions.

- (4) Nancy Olewiler of Queen's University presented a perspective on the "level playing field" and how it might be defined. While the concept is defineable for perfect markets, she challenged its relevance to the analysis of energy policy in the real world.

Plenary and small group discussions brought out a wide range of perspectives on the appropriate principles for pricing and taxation of the various energy sources. The views of the seminar participants are summarized below in the form of a series of propositions, designed to serve as a starting point for discussion in Montreal.

Energy Pricing

Market forces, rather than government policy objectives, should play the dominant role in determining energy prices in Canada.

- . This means accepting changes emanating from international oil markets, including changes in OPEC policies.
- . In the event of disruptions in energy markets, prices should continue to be set by market forces. To ease such disruptions, governments should maintain ample inventory, improve regional preparedness and provide short-term transitional assistance to energy users through the tax/transfer system.
- . Can a market-based system work effectively if utility boards regulate the retail prices of motive fuels and natural gas?

Canadian electricity rates, by contrast, are determined largely in regulated markets, and reflect a cost-based pricing structure.

- . Is this approach consistent with the concept of fair inter-fuel competition?
- . Current utility rate structures or policies may not encourage economic parallel generation projects to proceed.

Prices of all sources of energy should, to the extent possible, reflect their full cost of production including the cost of capital, the cost of resources and inputs, and the cost of environmental pollution.

- . This is particularly applicable to regulated, cost-based energy industries and to the export of all energy commodities.

Governments should not distort market prices to achieve other objectives such as energy development or the redistribution of energy revenues.

- . The results of price intervention in the 1970's and 1980's would strongly support not using price as a policy instrument.

Energy Fiscal Regime

The present energy fiscal regime is likely incapable of dealing in a politically acceptable way with a major energy price increase.

- . A more flexible and robust fiscal regime for oil and gas should be in place before the next oil shock.
- . There was no consensus on how the fiscal regime should be changed but flexible provincial royalties and changes to the federal resource allowance were discussed as interesting options.
- . Any national redistribution mechanisms should operate through the general tax system or equalization.
- . Consistency and predictability in fiscal policy is essential to energy investments, particularly in projects with long lead times.

Governments have a role in ensuring that environmental costs are "internalized" by energy producing industries and are fully reflected in energy prices.

- . There was significant divergence on whether environmental regulations or taxes would best internalize these costs.

Fiscal incentives should not be used to encourage particular patterns of energy development and use (e.g. megaprojects, alternative energy, conservation) provided that market forces are operating and prices reflect full costs.

- . Governments have a role to intervene to encourage competition, to ensure fair market access, and to provide information on energy alternatives.

In a market based energy economy, it is often asserted that the "playing field should be level" for all participants.

- . Consensus on the definition of the "level playing field" either among energy industries or between energy and other sectors of economy was not achieved.
- . It was recognized, however, that not all energy industries currently operate on a level playing field and that governments have a role in monitoring and correcting unintended market distortions.